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E.O. 12958: N/A

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SUBJECT: FRANCE: FIRST QUARTER GDP GROWTH DISAPPOINTING

REF: Paris 1233

11. SUMMARY: French GDP growth did not accelerate in the first quarter contrary to expectations, increasing only 2.0 percent (annualized) compared to the fourth quarter of 2006. GDP growth was still heavily dependent on consumption, but export growth rebounded. INSEE is now using European and U.S. standards (the preceding year price basis) to calculate GDP data. END SUMMARY

#### The 2.0 Percent Increase in GDP in Q-1 Disappoints

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12. GDP (seasonally and work-day adjusted) increased 2.0 percent (annualized) in Q-1 as forecast by the National Statistical Agency (INSEE) in March (reftel). But, it was a disappointment for outgoing Finance Minister Thierry Breton, who had said on May 7 that he thought GDP growth was "on a 2.5-3.0 percent pace in Q-1 and Q-2." The Bank of France and private-sector economists forecast a 2.4 percent increase (annualized) in Q-1. On May 14 the European Commission revised upward its GDP growth forecast for France by 0.2 percent to 2.4 percent in 2007.

#### Household Consumption and Exports Drive Growth

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13. GDP was mainly led by household consumption, which showed a 1.2 percent (annualized) increase in Q-1, while corporate investment increased 5.6 percent (annualized). Despite the strong Euro, exports showed a 6.0 percent (annualized) rebound, led in part by automobile and capital goods sales. Domestic demand and foreign trade had a positive contribution to GDP growth in Q-1, while inventories had a negative impact.

#### Economists Called for Vigilance

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14. Private-sector economists warned that corporate investment has been sluggish, and not sufficiently concentrated on innovation. Economic growth could be harmed by a new rise in oil prices, a further decrease in the USD against the euro or an increase in consumer prices. Inflation remained moderate, but consumer prices increased at a faster pace in the last few months (1.3 percent year over year in April compared with 1.0 percent in February and 1.2 percent in March).

#### INSEE Revised 2005 and 2006 GDP Growth

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15. Due to a change in methodology, INSEE revised upward 2005 GDP growth to 1.7 percent (versus 1.2 percent) and 2006 GDP growth to 2.2 percent (versus 2.1 percent). The estimate of GDP growth is now based on the preceding year prices, no longer on the 2000 constant price basis. The new method, which is already used in most European countries, provides a better estimate of aggregates. The new

estimate of the consumption of electronic products takes into account the significant regular decrease in prices.

#### Budget Deficit and Public Debt Decreased in 2006

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16. INSEE confirmed that the budget deficit and the public debt decreased to 2.5 percent from 3.0 percent of GDP in 2005. The public debt decreased to 63.7 percent of GDP in 2006 (versus an initial estimate of 63.9 percent).

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